

Message Text

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ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 EURE-00 NEA-14 CIAE-00 DODE-00

PM-07 H-03 INR-11 L-03 NSAE-00 NSC-07 PA-04 RSC-01

PRS-01 SP-03 SS-20 USIA-15 AID-20 COME-00 EB-11

FRB-03 TRSE-00 XMB-07 OPIC-12 CIEP-03 LAB-06 SIL-01

OMB-01 STR-08 CEA-02 FEA-02 INT-08 DRC-01 /211 W

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P R 261548Z SEP 74

FM AMEMBASSY LONDON

TO SECSTATE WASHDC PRIORITY 4255

INFO AMEMBASSY BONN

AMEMBASSY PARIS

AMEMBASSY ROME

AMEMBASSY TOKYO

USMISSION EC BRUSSELS

USMISSION OECD PARIS

C O N F I D E N T I A L SECTION 1 OF 2 LONDON 12558

DEPARTMENT ALSO PASS TREASURY AND FRB

E.O. 11652: GDS

TAGS: EFIN, UK

SUBJECT: ARAB FINANCIAL FLOWS AND EUROCURRENCY MARKET
DEVELOPMENTS

REF: LONDON 10695, LONDON 9085, LONDON 7997

SUMMARY: CONVERSATIONS WITH US AND BRITISH BANKERS INDICATE HEAVY ARAB FINANCIAL INFLOWS CONTINUE TO BE RECEIVED AND ARE STILL GENERALLY CONCENTRATED AMONG A SELECTED NUMBER OF MAJOR BANKS. THESE BANKS CONTINUE TO BID WELL BELOW THE NOMINAL RATE AND RECEIVE FUNDS, PRIMARILY CONCENTRATED IN CALL AND SHORT-TERM DEPOSITS. FUNDS ALSO CONTINUE TO FLOW INTO STERLING. DETAILS OF CURRENT FLOWS
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CANNOT BE QUANTIFIED. BANK OF ENGLAND SEPTEMBER BULLETINGN

SHOWS APPROXIMATE INCREASES IN HOLDINGS OF MIDDLE EAST OIL PRODUCERS, ALGERIA, INDONESIA AND VENEZUELA, OF \$4.6 BILLION IN EURO CURRENCY AND \$1.3 BILLION IN STERLING RESERVES DURING SECOND QUARTER.

GENERAL VIEW AMONG PRIVATE BANKERS IS THAT MARKETS HAVE DONE A GOOD JOB OF RECYCLING DURING THE FIRST HALF YEAR. BANKERS ARE APPREHENSIVE ABOUT PRIVATE MARKET'S CONTINUED ABILITY TO HANDLE FUTURE FLOWS, SUGGESTING THAT MORE DIRECT PLACEMENTS BY OIL PRODUCERS WITH CONSUMER GOVERNMENTS AND INTERNATIONAL INSTITUTIONS MUST AT LEAST BE A PARTIAL SOLUTION. SOME CITE EXPOSURE LIMITATIONS TO BORROWERS ON AN INSTITUTIONAL, GOVERNMENTAL OR COUNTRY BASIS, AS WELL AS THE BANKS OWN CAPITAL ADEQUACY AND BALANCE SHEET STRUCTURE PROBLEMS. FOREIGN EXCHANGE DEALINGS ARE RESTRAINED, LIMITED ALMOST EXCLUSIVELY TO COMMERCIAL TRANSACTIONS. THERE ARE SIGNS THAT CONSORTIUM BANKS AND SMALL US BRANCH BANK OPERATIONS ARE LESS PROFITABLE, WITH SOME SMALLER REGIONAL US BANKS REPORTEDLY WONDERING WHAT ROLE THEY NOW HAVE TO PLAY IN THE LONDON MARKET. UK BANKERS BEARISH ON STERLING, ALSO CITE SERIOUS LIQUIDITY STRAINS ON INDUSTRY IN CONTEXT OF DOMESTIC STERLING MARKET OPERATIONS. END SUMMARY.

1. THIS IS CONTINUATION OF PERIODIC REPORTING ON SUBJECT. FOR BACKGROUND, SEE REFTELS. THIS MESSAGE SUMMARIZES MOST RECENT CONVERSATIONS TREASURY REPS HAVE HAD WITH UK AND US BANKERS AND WITH BANK OF ENGLAND OFFICIALS ON ARAB FINANCIAL FLOWS, EURO CURRENCY AND STERLING DEVELOPMENTS. EURO CURRENCY, ESPECIALLY EURO DOLLAR DEPOSITS CONTINUE TO BE HEAVILY RECEIVED IN LONDON, ALTHOUGH CONCENTRATED AMONG FAVORED INSTITUTIONS, WHICH FOR US INCLUDES BANK OF AMERICA, CHASE MANHATTAN, CITIBANK AND MORGAN GUARANTY. TWO OF THESE INSTITUTIONS REPORT IN CONFIDENCE THEY ARE STILL RECEIVING HEAVY SHORT-TERM ARAB DEPOSITS DESPITE FACT THEY ARE BIDDING FROM 100 TO 200 BASIS POINTS BELOW CURRENT MARKET RATES. OTHER US BANKS, INCLUDING SOME LARGE AND MEDIUM-SIZED NEW YORK BANKS, SAY THAT BIDS 50 TO 75 BASIS POINTS BELOW CURRENT MARKET ARE MORE FREQUENT TO DISCOURAGE DEPOSITS, ALTHOUGH EVEN IN THESE CASES, DE-CONFIDENTIAL

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POSITS STILL BEING MADE. WHEN MEDIUM-SIZED, GOOD NAME BANKS RECEIVE THESE FUNDS, SOME THEN TRY TO LAY THEM OFF UP THE LINE, I.E., WITH LARGER US BANKS. WE HEAR CONFLICTING STORIES ABOUT ABILITY OF SMALLER US BANKS TO ATTRACT ARAB DEPOSITS. ON BALANCE, MOST APPEAR NOT REPEAT NOT TO BE SUCCESSFUL.

2. THE SHARP PREMIUMS ABOVE NOMINAL RATES OFFERED BY JAP-

ANESE AND ITALIAN BANKS SEEKING DEPOSITS REPORTEDLY FELL IN PAST WEEKS AS SOME FAVORED BANKS FOUND IT NECESSARY TO LAY OFF UNWANTED FUNDS, WITH SOME RECHANNELING TO ITALINA AND JAPANESE BANKS. AS RESULT, PREMIUMS BID BY THESE INSTITUTIONS DROPPED. MAJOR JAPANESE BANK ON SEPTEMBER 24 WAS REPORTEDLY BIDDING FOR DOLLARS AT 3/8 PERCENT PREMIUM ABOVE NOMINAL BID RATE. JAPANESE SOURCE SAYS AT LEAST 1/4 PERCENT PREMIUM STILL USUAL FOR JAPANESE BANKS BIDDING FOR FUNDS.

3. ARABS CONTINUE TO SHOW STRONG SHORT-TERMS LIQUIDITY PREFERENCE WHICH BANKERS HERE CLAIM IS PLACING STRAINS ON THE INTERMEDIATION PROCESS. STRAINS ON CAPITAL STRUCTURE AND BALANCE SHEET COMPOSITION OF THE FINANCIAL INSTITUTIONS TAKING THE DEPOSITS FREQUENTLY CITED. RECENT DROP IN CALL RATES AND SHIFT TOWARDS MORE NORMAL YIELD CURVE STRUCTURE CITED AS A GOOD OMEN, BUT NOT MUCH MORE. LARGER US BANKS APPARENTLY MORE CLOSELY EXAMINING THEIR CREDIT EXTENSIONS. SOME BORROWERS ARE CLOSE TO THE BANK'S EXPOSURE LIMITS ON INDIVIDUAL COMPANY, INSTITUTION, GOVERNMENT OR COUNTRY BASIS. THIS MUCH SAID, TREND INCREASINGLY IS TOWARD HIGHER MARGINS OVER LIBO ON LENDING, REPORTEDLY 3/4 PERCENT ON VERY SHORT LENDING AND ONE PERCENT OR HIGHER ON LENDING OVER SIX MONTHS. BORROWERS REPORTEDLY ACCEPT THIS WITHOUT MUCH COMPLAINT. SOME BANKERS CONSIDER THIS NECESSARY TO ENABLE BANKS NOT RECEIVING ARAB DEPOSITS UNDER MARKET RATES TO PARTICIPATE IN SYNDICATED OFFERINGS, OTHERS SAY IT IS A MORE ADEQUATE REFLECTION OF RISK AND BANKS' NEED TO EXPAND THEIR CAPITAL BASE THOUGH INCREASED PROFIT.

4. THERE IS FEELING HERE THAT DOLLAR DEPOSITS PLACED IN

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ACTION EUR-25

INFO OCT-01 EA-11 ISO-00 EURE-00 NEA-14 CIAE-00 DODE-00

PM-07 H-03 INR-11 L-03 NSAE-00 NSC-07 PA-04 RSC-01

PRS-01 SP-03 SS-20 USIA-15 AID-20 COME-00 EB-11

FRB-03 TRSE-00 XMB-07 OPIC-12 CIEP-03 LAB-06 SIL-01

OMB-01 STR-08 CEA-02 FEA-02 DRC-01 INT-08 /211 W

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P R 261548Z SEP 74

FM AMEMBASSY LONDON

TO SECSTATE WASHDC PRIORITY 4266

INFO AMEMBASSY BONN

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C O N F I D E N T I A L SECTION 2 OF 2 LONDON 12558

LONDON MARKET ARE NOT GROWING AS FAST OR IN SAME PROPORTION AS THOSE BEING RECEIVED IN NEW YORK. OVERALL DEFENSIVE TONE OF THE EUROMARKET CONTINUES WITH REPORTS OF INCREASED DIFFICULTIES IN ARRANGING SYNDICATED LOANS. FEWER OF THESE ARE PUBLICLY ADVERTISED. WHEN TOMBSTONES ARE PUBLISHED, THEY SHOW FEWER NAMES INVOLVED, INDICATING DIFFICULTIES FACED BY SMALLER BANKS IN OBTAINING DEPOSITS AND IN TURN PARTICIPATING IN SYNDICATED OFFERINGS. VOLUME OF FOREIGN EXCHANGE MARKET ACTIVITY REMAINS SHARPLY REDUCED, LINKED ALMOST EXCLUSIVELY TO COMMERCIAL TRANSACTIONS.

5. BANK OF ENGLAND OFFICIALS AND REPRESENTATIVES OF LARGER US BANKS OPENLY WONDER HOW MUCH LONGER SOME OF THE SMALLER REGIONAL US BRANCHES IN LONDON WILL REMAIN HERE, AT LEAST IF THEIR DECISIONS ARE BASED ON PROFITABILITY OF
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THE OPERATION. DIFFICULTIES FACING AT LEAST SOME CONSORTIUM BANKS CITED IN LONDON 12423.

6. DATA PUBLISHED IN BANK OF ENGLAND SEPTEMBER QUARTERLY BULLETIN SHOWS FOREIGN CURRENCY DEPOSITS OF MIDDLE EAST OIL PRODUCERS INCREASED FROM 1.7 BILLION POUNDS EQUIVALENT IN DECEMBER 73 TO 2.6 BILLION POUNDS IN MARCH 74 TO 4.3 BILLION POUNDS IN JUNE. DURING SIX-MONTH PERIOD, VENEZUELAN DEPOSITS INCREASED 62 MILLION, ALGERIAN 202 MILLION AND INDONESIAN 95 MILLION POUNDS EQUIVALENT. TOTAL IS 2.9 BILLION POUNDS EQUIVALENT, ROUGHLY 6.9 BILLION DOLLARS AT \$2.39. IN SAME PERIOD, EXCHANGE RESERVES IN STERLING HELD BY OIL PRODUCING COUNTRIES INCREASED FROM 950 MILLION POUNDS IN DECEMBER 73 TO 1.3 BILLION POUNDS IN MARCH 74 TO 1.8 BILLION POUNDS END JUNE, AN INCREASE OF 884 MILLION POUNDS OR 2.1 BILLION DOLLAR EQUIVALENT DURING FIRST SIX MONTHS. TOTAL OF BOTH IN DOLLAR EQUIVALENT ROUGHLY 9 BIL-

LION DOLLARS. NEW BANK OF ENGLAND FORMAT MAKES IDENTIFICATION OF THESE FLOWS SOMEWHAT EASIER BUT SOME AMBIGUITIES REMAIN.

7. UK CLEARING AND INVESTMENT BANKS SAY ARAB FLOWS INTO STERLING CONTINUE. ALTHOUGH SOME DEPOSITS APPEAR TO BE A BIT MORE NERVOUS, WITH REPORTS THAT BOTH OIL COMPANIES AND ARAB PRODUCERS HAVE REDUCED AMOUNTS OF NEW FUNDS FLOWING INTO STERLING SINCE JULY. HOWEVER BANK OF ENGLAND SOURCE STATES THAT ARAB FLOWS INTO STERLING HAVE CONTINUED TO HAVE BENEFICIAL EFFECT IN SUPPORTING STERLING IN FOREIGN EXCHANGE MARKETS. THERE ARE INDICATIONS THAT SOME ARAB STERLING FUNDS ARE BEING PLACED LONGER TERM, BUT NO HARD INFORMATION ON TERMS AND MATURITIES. ARAB INTEREST IN UK REAL ESTATE CONTINUES. KUWAIT INTERESTS HAVE MADE A 107 MILLION POUND TAKEOVER BID FOR CONTROL OF ST. MARTIN'S PROPERTY COMPANY; IT WILL PROBABLY BE SUCCESSFUL, AND HAD PRIOR APPROVAL OF UK TREASURY.

8. LONGER TERM, UK BANKERS ARE GLOOMY ON OUTLOOK FOR STERLING (SEE LONDON 12356). THEY CONSIDER THAT WEAK POSITION OF THE UK ECONOMY HAS BECOME BETTER APPRECIATED INTERNATIONALLY DURING PAST WEEKS AND THAT IF ANYTHING CURRENT ELECTION CAMPAIGN WILL EXACERBATE THE TREND.
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ECONOMIC ADVISER OF ONE MAJOR CLEARING BANK SUMMARIZED HIS VIEWS SAYING THE WORLD IS IN BAD SHAPE BUT IN BRITAIN THE SITUATION IS WORSE, HENCE THERE IS HEAVY INCENTIVE TO GET OUT OF STERLING. IN GENERAL, THE CITY FEARS THE EFFECTS OF A LABOUR VICTORY, WHICH IT CONSIDERS WILL LEAD TO INCREASED LEFT WING POLICIES AND EVANTUALLY TO DECREASED INDUSTRIAL EFFICIENCY AS A RESULT OF INCREASED GOVERNMENT INTERVENTION. UK FINANCIAL SOURCES ALSO CITE LABOUR PARTY MANIFESTO WHICH STATES LABOUR SHALL BRING FORWARD EARLY PROPOSALS TO INSURE THAT BANKING AND INSURANCE MAKE A BETTER CONTRIBUTION TO NATIONAL ECONOMY. THE POOR CONDITION OF NEW YORK AND PARTICULARLY UK STOCK EXCHANGE ADDS TO THE GLOOM. WHEREAS US BANKERS ARE GENERALLY APPREHENSIVE, CONTACTS IN UK FINANCIAL INSTITUTIONS ARE DEPRESSED AND SOME ALMOST DEVOID OF CONFIDENCE PENDING THE ELECTION OUTCOME.

9. MORE IMMEDIATE CONCERNS OF UK BANKERS INCLUDE FEARS OF AN IMPENDING LIQUIDITY CRISIS IN STERLING BANKING CIRCLES. MAJOR COMPANIES HAVE CASH FLOW PROBLEMS AND, GIVEN WEAKNESSES OF EQUITY AND DEBT MARKETS, HAVE BEEN KEPT AFOAT BY BANK LENDING. ONE MAJOR COMPANY, FERRANTI, IS ALREADY KNOWN TO BE IN CRISIS. AS RESULT OF PRICE CODE AND OTHER CONSTRAINTS ON CASH FLOW, FOOD PROCESSING INDUSTRY IS RE-

PORTEDLY ON VERGE OF A MAJOR CRISIS WHICH MAY REVERBATE
INTO OTHER SECTIONS OF BRITISH INDUSTRY.

10. EARLIER GENERAL CAVEAT ON THIS TYPE REPORTING REMAINS
VALID. ABOVE REPRESENTS DISTILLATIONS OF CONVERSATIONS
WITH US AND UK BROKERAGE, COMMERCIAL AND INVESTMENT BANK-
ERS DURING PAST TWO WEEKS. VIEWS HEARD HAVE NOT BEEN UNI-
FORM. ALTHOUGH THEY COME FROM USUALLY HIGHLY RELIABLE
AND SENIOR SOURCES, THEY SHOULD BE TAKEN WITH A GRAIN OF
SALT BECAUSE NO ONE HERE SEES THE ENTIRE PICTURE. SIMI-
LAR INFORMATION UNDOUBTEDLY EXISTS IN NEW YORK AND OTHER
MAJOR CONTINENTAL FINANCIAL CENTERS. ABOVE IS OFFERED AS
OUR BEST ESTIMATE ON HOW THESE ISSUES CURRENTLY ARE SEEN
FROM THE LONDON FINANCIAL MARKET.

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: PETROLEUM, FOREIGN INVESTMENTS, BANK LOANS, FOREIGN EXCHANGE RATES, ECONOMIC TRENDS
Control Number: n/a
Copy: SINGLE
Draft Date: 26 SEP 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: golinofr
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974LONDON12558
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D740271-1105
From: LONDON
Handling Restrictions: n/a
Image Path:
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Legacy Key: link1974/newtext/t19740912/aaaaajsu.tel
Line Count: 292
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: LONDON 10695, LONDON 9085, LONDON 79, 97
Review Action: RELEASED, APPROVED
Review Authority: golinofr
Review Comment: n/a
Review Content Flags:
Review Date: 09 APR 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <09 APR 2002 by cunninfx>; APPROVED <10 JUL 2002 by golinofr>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ARAB FINANCIAL FLOWS AND EURO CURRENCY MARKET DEVELOPMENTS
TAGS: EFIN, UK
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005